# RATE-MAKING ORGANIZATIONS IN FIRE INSURANCE

By Robert Riegel, Ph.D.,

Instructor in Insurance, Wharton School of Finance and Commerce, University of Pennsylvania.

## The Antagonistic Principles of Competition and Coöperation

During the recent development of fire insurance in the United States the problem of the medium or agency through which rates should be promulgated has given rise to two radically different solutions. These solutions are irreconcilable mainly by reason of the opposing premises upon which they rest. One presupposes that competition is the most effective method of securing justice in rates as between communities, classes of risks and persons, while the other assumes that the greatest measure of equity will be attained through coöperation.

The trend of thought of the advocates of competition is based upon history and analogy. Having observed instances of large combinations exacting exorbitant profits through freedom from competition, their conclusion is that lack of competition is the cause of extortion and that restoration of rivalry is the logical remedy. What more natural than to apply such a general conclusion to the business of fire insurance with the resulting conviction that the public welfare in this field will be best protected by denying combined action with respect to rates of premium? In this predisposed state of mind every united effort of underwriters is viewed as inimical to public welfare, and every association as a "combination in restraint of trade." Thus an association of agents in Missouri, designed to secure concerted action in the quoting of fire insurance rates, was characterized by the court as "a plain, palpable, but bungling pool, trust, agreement, combination, confederation and understanding, organized to avoid said anti-trust statute." [1] The inevitable result of such convictions is the enactment of anti-monopoly, anti-trust and anti-compact legislation.

[1] State *v.* Firemens Fund Ins. Co., 150 Mo. 113 (1899).

The reasoning of those who extol the benefits of coöperation coincides with that of the advocates of competition as far as a portion of the argument is concerned, agreeing that combinations have at times proved detrimental to public welfare. But here the similarity in thought ceases. Those who favor coöperation maintain that combinations and monopolies are not killed but fostered by competition and that a greater evil, discrimination between consumers, is traceable to the unregulated endeavor to obtain business. Applying their thought to the field of fire insurance, combinations of underwriters were an economic necessity because militant competition had not merely made the business unprofitable but had threatened the very existence of many companies. Those in the occupation believed that if such conditions continued a survival of the strongest would inevitably result and all the business fall under the absolute control of a few large companies. The only remedy appeared to be associated action. On the other hand this competition was resulting in discrimination between individual policyholders, but with no benefit to policyholders as a class. In a struggle to obtain business each company felt justified in offering inducements where necessary to secure the risk and the richest and most powerful property owners were those who secured the greatest concessions. These were at the expense of the weak, of course, since in the end aggregate premiums must be sufficient to pay aggregate losses and expenses. In many companies, where the sacrifices made in some directions could not be counterbalanced in others, safety and continued existence were endangered. The small insured, therefore, not only derived no benefit from the cutting of rates but saw the value of his indemnity—which depends upon the strength of the insurer—steadily depreciating. Inasmuch as business was secured through agents, furthermore, competition caused commissions to rise to exorbitant figures at times, to the added burden of the insured.

Such are the facts and conclusions furnished by the advocates of competition and their adversaries and the history of fire insurance legislation affecting rates is largely a history of the conflict of these two ideas.

## THE DEVELOPMENT OF COÖPERATION

Relatively early in our history dissatisfaction with unhindered competition and its attendant rate-cutting was apparent. Advances

toward united effort, however, were spasmodic and results merely temporary. In New York City, for example, a rate agreement was made in 1821, but by 1825 the number of new companies formed so increased competition as to cause its abandonment. In 1826 an association was formed for similar purposes but by 1843 had ceased existence. In 1845 rates were again raised to a profitable basis, and from 1849 to 1865 New York City witnessed the establishment of no less than seventy new companies. Similar experiences are recorded in the annals of the Hartford Board of Fire Underwriters and other long-established boards. In 1866 an effort of far greater scope brought about the formation of the National Board of Fire Underwriters, composed of seventy-five companies, with the common purpose to "establish and maintain, as far as practicable, a system of uniform rates of premium."

A rating bureau was organized by the National Board and the United States divided into six territorial departments for the purposes of rate-making. In 1868 thirty-seven leading companies entered into the "Chicago Compact," pledging themselves to remove any local agent upon the second conviction for violating National Board rates. But by 1870 it was officially though reluctantly acknowledged that rates were not being generally adhered to and they were suspended. Following the Chicago fire in 1871 and the Boston conflagration in 1872 premiums were again temporarily maintained, but by 1876 conditions had returned to the usual state of demoralization, and in 1877 the rate-making function of the Board was abandoned in favor of local and sectional boards of fire underwriters, which have continued important factors until the present time. Practically the entire country is now supervised by a group of associations and bureaus.[2]

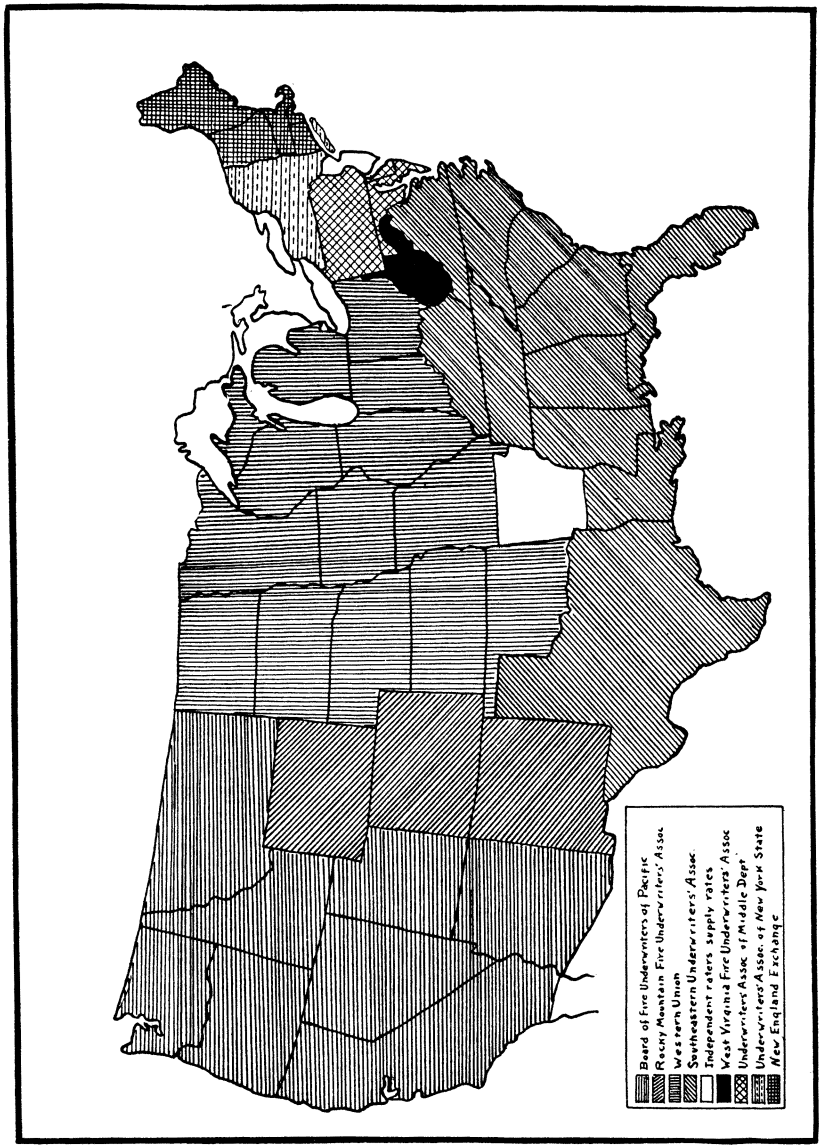
## THE NATURE AND SERVICES OF UNDERWRITERS' ASSOCIATIONS

*Classification of Associations.* On a territorial basis, associations of fire underwriters may be classed as national, sectional and local. Since the relinquishment by the National Board of the rate-making function, the national associations have concerned themselves with educational and technical activities such as the promotion of harmony, correct practices, repression of arson and

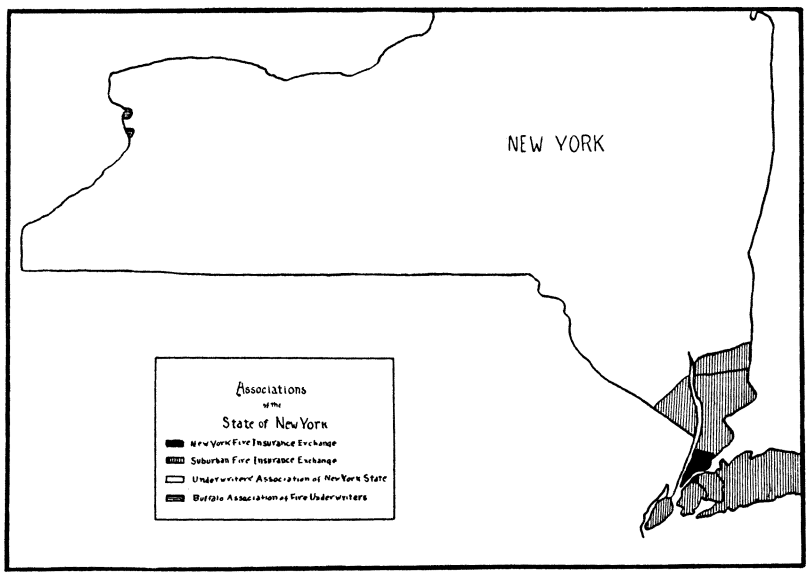
[2] See map on page 176.

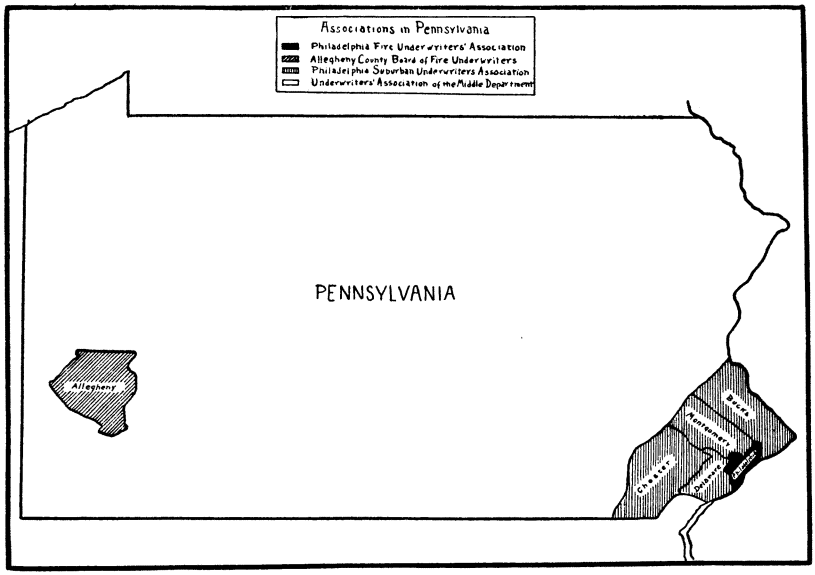
incendiarism, compilation of statistics, securing the adoption of uniform policies and clauses, promoting equitable adjustment of losses, encouraging improved and safe methods of building construction, fire protective measures and adequate fire departments. These associations, although of the highest importance, were not directly connected with fire insurance rates from 1877 to 1914.

The respective territories of the sectional organizations include from one to thirteen states of the United States. The Western Union, for example, approximately covers the Middle West; the Association of the Middle Department has jurisdiction in Pennsylvania, Delaware, Maryland and West Virginia. Such organizations perform, in a broader way, functions similar to those of the local boards, described later. The following map shows the jurisdiction of a number of the prominent sectional organizations:


Board of Fire Underwriters of Pacific
Rocky Mountain Fire Underwriters' Assn.
Western Union
Southeastern Underwriters' Assoc
Independent raters supply rates
West Virginia Fire Underwriters' Assoc
Underwriters' Assoc. of Middle Dept.
Underwriters' Assoc. of New York State
New England Exchange

But in many cities of great importance in the states controlled by sectional organizations we find local associations exercising authority over fire rates. This is true, for example, of New York, Philadelphia, Boston and Baltimore. The term "local" is somewhat general, but is best restricted to an association operating within a large city or in the adjacent suburbs. Local associations may be subclassified as urban and suburban. Thus the New York Fire Insurance Exchange confines its activities principally to Manhattan, the Bronx and Brooklyn, while the Suburban Fire Insurance Exchange supervises four adjacent counties and certain other specially designated territory. The following maps show typical examples of division of territory between such associations:






*Organization of Underwriters' Associations.* As is true of many business associations of the present day, the government of the exchanges is in the main a government by committees. An executive committee, usually elective, is in general control of all the activities of the organization, exercising universal supervision but delegating a large portion of the actual work to a number of standing committees. Four such committees at least are usually found in all associations. A committee on brokerage prescribes rules for admission to the association, investigates applications for membership and issues certificates to the successful applicants. In some cases this committee acts as a court to investigate complaints against members but an appeal may generally be taken from its decision to an arbitration committee. The latter hears these and other cases which lie within its jurisdiction and upon conviction imposes the appropriate penalty, usually consisting of a fine, enforced cancellation of policies involved, or of preventing the offending member from writing a particular risk or risks, either directly or by reinsurance, for one year. The latter may involve considerable loss of business. For grave offences the accused may be expelled. A committee on losses and adjustments usually exists for

the purpose of promoting good practice and equity in the settlement of fire losses. In some cases such committees have been instrumental in obtaining the adoption of uniform rules to govern complicated adjustments. One of the most important committees is the committee on rates, which deals directly with the larger problems of rate-making and delegates certain duties to the secretary of the exchange and an inspection and rating department. Through the committee on rates the association fixes specific and minimum rates for the writing of insurance, which are adhered to throughout its jurisdiction. A minimum rate applies to all risks of a same general description, such as dwellings. Specific rates are rates on individual risks specified by location and description, and usually arrived at by the use of "schedules."

*The Economic Functions of Underwriters' Associations.* From the brief description given of competitive conditions and the origin of associations it is evident that they were economic necessities. One of the founders of the National Board said in 1866: "Without an organization of this kind insurance companies would be in the position of Kilkenny cats. They would devour each other and leave nothing but the tips of their tails." [3] Formed to meet an economic need they have performed an economic service, although the benefits of their activities are often lost sight of in the criticism of their mistakes.

1. The Promotion of Economy. In the first place they have encouraged economy in the fixing of fire insurance premiums. A common organization now performs for all companies in an efficient manner the work which was once performed by each company individually in any manner it saw fit, accomplishing an enormous saving in labor and expense; and it must be remembered that the insured's premium pays for expenses as well as losses. Coincident therewith have come the benefits of specialization and division of labor. Instead of a company representative inspecting and rating at the same time, a trained inspector hands over the result of his labor to a department trained to apply the appropriate rating schedule to the conditions as set forth in his report. In the second place, through the establishment of uniform rates of commission to brokers and agents, the acquisition costs have been kept lower

[3] Mark Howard, at the convention called to organize the National Board of Fire Underwriters.

than would otherwise have been the case. Regulation of commissions, it must be admitted, has not yet reached the standard of regulation of rates, but it has eliminated the former enormous sporadic increases of commission rates during influxes of competition. Likewise it has done much to eradicate the evils of the rebate, which entails a preference of one policyholder over another. Thirdly, the association has provided coöperative action against legislation prejudicial to the companies and often to both the companies and the public, as for instance, valued policy and retaliatory laws. A protective alliance is the only defence against state legislation which one year permits companies to employ a common expert to make rates and the next year makes any combination of this nature a penitentiary offence.

2. Standardization. The associations have in many ways promoted the standardization of rates and rating systems. They have furnished a permanent means for the constant study of the process of arriving at an equitable rate and have been of vast assistance in the formation of rating schedules, which mark the great steps in the development of fire insurance rating from a guess to a science. Partially successful schedules once attained, they have furnished a medium or agency for the application of the same with the least cost. One of their greatest services has been the creation of uniformity in charges and the prevention of discrimination between localities, classes of risks, kinds of policies and persons. They have eliminated the rate-wars previously referred to, with their demoralization of business and deterioration in the value of the insured's policy. They have attempted the classification of loss statistics, although this activity never reached adequate importance until 1914, when the National Board of Fire Underwriters again interested itself in the subject of rates. Through the medium of certain associations standard tables have been adopted for quoting rates on insurance for a term of less than one year, known as short-rate tables. The fire insurance associations have also been instrumental in the adoption of a standard fire policy, the meaning of which has been largely settled by the courts, and the adoption of standard endorsements and clauses adequate to meet exceptional circumstances.

3. General Results. In addition to the above, the establishment of associations has had certain beneficial results difficult to

classify, such as the elimination of objectionable practices, expulsion from the business of undesirable members, mutual counsel, mutual assistance and prevention of and protection against fire.

### DEVELOPMENT OF THE PRINCIPLE OF COMPETITION

*The Common Law.*[4] In the absence of anti-trust statutes, or where these laws have been held not to apply to combinations of insurance companies, the common law is available for the redress of real or fancied public grievances. For many years this was the only protection in some states against combinations prejudicial to general interests and we find several cases of proceedings against underwriters' associations under the common law. Its principle, in brief, is that any agreements in restraint of trade which are against public policy are void and unenforceable. They are sometimes called "illegal" but only in the above sense, it is generally admitted. Every case brought under the common law must, therefore, be judged in the light of the attendant circumstances. Does the association unduly restrain trade or is it contrary to public policy? Full discussions of the application of this principle to various other businesses can be found elsewhere[5] and we may consider here only cases directly involving fire insurance.

The general principle stated above was upheld by the court in a comparatively recent case in the following words: "The most that can be said as to the combination to fix, regulate and control the business of fire insurance in the city of Newport News is that it was an agreement in restraint of trade. But agreements merely in restraint of trade are not illegal in the sense that they are either indictable or actionable." [6] In another case a party to an agreement complained when its terms were applied to him but the court refused him aid inasmuch as he had "caused the injury of which he complained by his unlawful acts." [7]

Associations of fire underwriters have been attacked on the

[4] For a more detailed consideration of cases involving fire underwriters' associations see the author's *Fire Underwriters' Associations in the United States*, Chronicle Co. Ltd., N. Y., 1915, pp. 53–55.

[5] See *Report of Commissioner of Corporations*, 1915, on "Trust Laws and Unfair Competition."

[6] Harris *v.* Commonwealth, 73 S. E., p. 563.

[7] Beechley *v.* Mulville, 102 Iowa 602.

ground of public policy, and under such circumstances it was necessary to show that unreasonable restraint affecting the public interest was exercised or that insurance should be considered an article of necessity. The view that insurance is affected with a public interest is well supported, but there is little ground for considering it an indispensable necessity of life. Owing to the difficulty of showing unreasonable restraint or the importance to the public of fire insurance, actions under the common law have not been very successful, although in some cases the courts have held certain acts of associations, such as regulating the intercourse of members, prohibiting members from having more than two agents in congested districts of a city, requiring the cancellation of risks written at other than the board rates, etc., to be contrary to public policy, void and illegal.

*Anti-Trust Statutes.*[8] With the development of the antipathy to the so-called "trusts" came the enactment of laws forbidding in general terms combinations which were designed to regulate competition or enhance or maintain prices. These laws were applicable to "trade," "commerce," "business," "dealings in commodities," etc., and the question soon arose of whether or not insurance might be considered within the scope of such expressions.

In several cases it was held that insurance could not be considered "trade" or a "commodity" in the sense in which those words were used in the statutes and that only by a strained construction could it be included within the term "commerce." The effect of such decisions was avoided in Texas by the insertion in the statute of the word "business." To include insurance within their jurisdiction the laws referred to would have had to be very specific and accurate in wording, and being designed to have a broad application, this they seldom were.[9] There is still doubt in some states as to whether or not laws of this type are applicable to insurance or not. Thus the secretary of state is of the opinion that the anti-trust law of Mississippi may be so construed.[10]

[8] For citations of laws of this nature existing in at least thirty states on January 1, 1914, and court cases which have arisen under the same, see the author's *Fire Underwriters' Associations in the United States*, pp. 55–56.

[9] For citations of cases involving these points see *Fire Underwriters' Associations in the United States*, pp. 55, 56.

[10] Spectator Co., *Fire Insurance Laws, Taxes, Fees*, 1915, p. 126.

*Anti-Compact Laws.*[11] Since it was doubtful, to say the least, whether insurance might be considered as within the scope of a general anti-trust statute, laws specifically enumerating insurance as a subject for legislation were passed which, in brief, forbade any combination or agreement for the purpose of regulating or fixing the "price or premium to be paid for insuring property against loss or damage by fire." Since the power to regulate insurance does not rest with the federal government, combinations to fix rates on business written within the state are valid subjects for the exercise of state powers, and in one case the court held such regulation of business to be a proper exercise of the police power. The state may expel from its territory companies which unlawfully participate in pools and combinations. Briefly summarizing the decisions on the validity of state action, they are to the effect that anti-compact laws do not violate state or federal constitutional provisions embodying right of contract, "equal protection of the laws" and "due process of law."

Various devices have been invented to evade the effect of such legislation, but with little success. Where agents formed an association the rules of which required the stamping of policies for the purpose of supervising rates and where an independent rater sold to the companies rates which were maintained by having policies pass through a "stamping department" the courts held that these were illegal attempts to evade the spirit of the law.[12] No tendency to limit the application of these laws is apparent, as in 1912 combinations to maintain rates, defined by law as "trusts," were again held to be unlawful.[13]

*Defects of Competition as a Basis for Rates.* All of the laws which have been thus far considered have had as their basic principle the idea that equitable rates and public benefit could be secured by repressing rates through competition. All actions against associations under the common law, under anti-trust statutes, and under laws prohibiting agreements regarding rates to be charged, were designed to keep insurers in a contest where

[11] For citations of laws and cases see *Fire Underwriters' Associations in the United States*, pp. 57–59.

[12] State *v.* Aetna Ins. Co., 150 Mo. 113 (1899) and State *v.* Firemen's Fund Ins. Co., 152 Mo. 1 (1899).

[13] State *v.* American Surety Co., 135 N. W. 365 (1912).

survival would require rates from which the insured might temporarily benefit. They were constant incentives, not to uniformity in rates, but to diversity. The assumption of the beneficence of competition in fire insurance rates is far from correct when considered in the light of the history of the business.

1. In the competitive struggle perpetuated by such laws it is not possible for policyholders, generally and as a class, to benefit. There are numerous property owners offering risks of such magnitude that their acquisition measurably swells the business of the company, and just as a manufacturer puts forth more effort to obtain a large contract than a small one, so insurance companies, in the competitive state, offer greater inducements in order to obtain a large risk than they would to obtain a small one. As in the railroad business under competitive rates the small shipper was discriminated against in favor of the large,[14] so in the fire insurance business under competitive rates the small property owner is discriminated against in favor of the large. Not only does the small property owner reap no benefit from the competition, but the premiums he pays must be sufficient to make up any deficiencies in the premium collections from large property holders.

2. Unrestrained competition may also otherwise adversely affect the insured. The commodity which he purchases, indemnity for possible loss, is not delivered upon payment of the premium but some time subsequently. When one is likely to call upon a corporation to deliver something in the future it is not desirable to so weaken that corporation as to make fulfilment of its contract doubtful; it is rather to the buyer's best interest to promote its solvency. Yet the periods of unrestrained competition in the past have been fruitful sources of fire insurance failures. As stated by the New York Legislative Investigating Committee, "The universal effect of such periods of open competition wherever and whenever they have occurred has been a cutting of rates to a point that was below the actual cost of the indemnity. . . . . The effect on all companies is weakening." [15]

3. It has been argued that since competition is esteemed a

[14] Hadley, *Railroad Transportation*, 1885. Johnson and Van Metre, *Principles of Railroad Transportation*, p. 511.

[15] 1911, p. 41. See also report of Illinois Commission, 1911; Wisconsin Legislative Committee, 1913.

satisfactory method for obtaining equitable prices in such industries as the grocery business or the shoe business there is no reason for not so regarding it in fire insurance. This ignores a fundamental difference between insurance and the kinds of business mentioned. In the grocery or shoe business there has never been a general recognition of the principle that prices should be based on cost; on the contrary it is well recognized that they are frequently not so determined. In nearly every discussion of fire insurance premiums, on the other hand, we find references to the desirability of having the "premiums commensurate with losses," "rates based upon the amount of hazard," "equity between localities" and similar expressions inferring that rates should vary with losses and expenses.[16] Even in other lines of business where cost does more or less enter as a price factor the cost is definitely known in advance and prices may be fixed conformably. In insurance the cost can only be estimated in advance, on the basis of experience; "it does not stare the underwriter in the face in the same way that the buying price of sugar confronts the grocer." [17] Consequently, under the stress of competition, the underwriter is more likely to reduce premiums below costs than the grocer to reduce selling prices below costs.

4. In the struggle for business which ensues upon the inauguration of rate competition it is but natural for the insurance company to avail itself, not only of rate reductions but of another almost equally effective inducement in securing business—increased commissions to agents and brokers. Thus the small insured, who derives no benefit from competition, sees himself constrained to contribute more in order to meet the increased cost of doing business entailed by it. As stated in the New York report, "Competition, therefore, in fire insurance has acted badly both as regards rates and expenses, but in different ways. It has driven rates too low and expenses too high." [18]

5. Finally, unrestrained competition, under present-day conditions, leads ultimately to monopoly through the elimination of the weak or unfortunate and the survival of a few large and strong

[16] See *e. g.*, conclusion of Illinois Investigating Commission, 1911, that the fire insurance rate is a tax.

[17] *Report of the New York Legislative Investigating Committee*, 1911, p. 42.

[18] *Report of Joint Committee to Investigate Insurance*, Feb., 1911, p. 94.

companies. A theory that prices tend toward costs is only partially true in a business where a good portion of expenses continue whether risks are written or not. It is true that when premiums rise and profits increase additional capital is attracted to the business and profits cease to rise; but the opposite, that when prices fall below costs competition for business will cease and prices tend to rise does not necessarily follow. For while competition for business at low rates may involve loss, not to compete often involves greater loss. Thus whether a company writes a risk at a low rate or not certain expenses of the business, such as maintaining agencies and a force of special agents and operating a home office continue, and they may form 20 per cent of all expenses. It is better to receive $1 in premium, although loss and expenses aggregate $1.05, than to receive no premium and pay 20 cents fixed expenses. Continuance of all business at a loss, of course, must ultimately result in failure and such has been the fate of many fire insurance companies.

## FURTHER DEVELOPMENT OF COÖPERATION

While the contest proceeded between coöperation on the one hand, represented by the associations, and competition on the other, represented by the anti-trust and anti-compact laws, some states departed from the line of procedure which had previously been followed; a departure which was extremely significant, not merely by reason of the type of law adopted but because of the relinquishment of the principle of competition. All the legislation thus far considered asserted in effect that there should be no combination, that each company should charge its own rates, that competition would determine their equity. Since under such conditions two different companies might quote different rates on the same risk, the states were saying in effect that there should be no measurement of hazard. Rates were to approximate costs, not by measurement but by competition. A new era of legislation had begun in some states, however.

*Laws Requiring the Filing of Rates.* For example laws were passed requiring corporations doing business in the state to file a schedule of rates with a state authority and requiring uniform premiums for all risks written under the same schedule. A common expert might be employed to inspect and rate risks and advise the

rates to be charged.[19] These are important simply as examples of *permission* to coöperatively determine rates.

*Laws Providing for Revision of Rates.* A second type of law required the filing of rates with the superintendent of insurance and invested him with power to order changed excessive, unreasonable or inadequate rates. Schedules and local tariffs were to be open to the inspection of the public and local agents were required to exhibit copies of the same. An appeal from the decision of the superintendent respecting rates might be taken to the district courts of the state.[20] These laws made it illegal to give special rates on any property not given to other property of equal hazard or to discriminate between persons. The title of one, for example, was: "An act relating to fire insurance and providing for the regulation and control of rates of premium thereon, and to prevent discrimination therein." The state is now on the road toward acknowledging the good features of coöperation; it realizes that a company should not discriminate between two equal risks and there only remains to be recognized the absurdity of two companies differing in rates on the same risk. The objectionable feature of the law to the companies was the extreme power seemingly vested in the insurance commissioner. This phase of the subject is discussed later.

*State Rating Acts.* Legislation of a more radical type speedily followed the laws providing for revision of rates, in the form of acts which create state commissions with power to actually fix rates in the first instance which shall be charged by the companies. The most noteworthy example of such a law is that of Texas.[21] In the words of the Insurance Commissioner of Texas:[22]

> If the state has the final say in the rate-making business, then I see no reason why the state should not make the rate in the first instance. We have state-made rates for fire insurance companies. We have a regular factory for making these fire insurance rates. The employes in that factory devote their entire time and attention to the study of the rate-making business. We have very experienced men employed in the department, about twenty-five in number, there

[19] See *e. g.*, Arkansas, Laws 1913, Act 159.

[20] Kansas, *e. g.*, Laws 1909, Chap. 152.

[21] Texas, Laws 1910.

[22] *National Convention of Insurance Commissioners*, September, 1915, p. 162.

being appropriated $100,000 annually for the payment of the expenses of making rates.

An act enabling similar action in Kentucky was the cause of considerable difficulty in 1912, which will be referred to later.

*Criticism of State Rating Acts.* The dissatisfaction of the companies with the Kansas act providing for a revision of rates by the insurance commissioner afforded an opportunity for the most important of recent decisions affecting fire insurance rates.[23] The law was attacked in the courts on the ground that fire insurance was a business of a private nature and that the law consequently was unconstitutional, amounting to an interference with the right of private contract, guaranteed by the Fourteenth Amendment. The majority decision held that "a business, by circumstances and its nature, may rise from private to be of public concern, and be subject, in consequence, to governmental regulation. . . . . Contracts of insurance, therefore, have greater public consequence than contracts between individuals to do or not to do a particular thing whose effect stops with the individuals. . . . . It is, therefore, within the principle we have announced." [24] The act in question was consequently held to be a valid exercise of the police power of the state. A strong dissenting opinion deplored the possibility so created of opening the way to state price-fixing with respect to many other kinds of articles and service.

But the acts which provided for rates actually made by the state occasioned the greatest consternation in the insurance fraternity, the results of which were most strongly evidenced in the case of Kentucky, where such a law was passed in 1912. After suggesting that this power be given to the Insurance Commissioner rather than to a state commission the companies threatened to withdraw from the state in a body. By March 9, 1914, twenty companies are reported to have withdrawn and by March 10, forty-seven companies had left the state. Meanwhile several events had concretely illustrated the prime necessity of fire insurance. A $150,000 fire occurred at Hodgensville in which twenty-three buildings were destroyed while covered by only $50,000 insurance. Most of the owners were unable to build without reim-

[23] German Alliance Ins. Co. *v.* Barnes, 189 Fed. 769 (1911), and German Alliance Ins. Co. *v.* Lewis, 34 Sup. Ct. 612.

[24] German Alliance Ins. Co. *v.* Lewis, pp. 618, 619, 620.

bursement for their losses or borrowing, and they were unable to obtain loans without insurance protection. Louisville banks, anxious about the security for their loans, began to inquire how much insurance was carried by their borrowers, how much matured each month, and what arrangements for its renewal had been made. Loans were outstanding on storage receipts representing alcoholic liquor in bond to the amount of approximately $162,000,000. The banks desired these loans liquidated if further insurance could not be obtained. Commercial credit was restricted by banks, wholesalers and manufacturers.[25] The pressure by business interests was so great that it was necessary to hold a conference to determine upon concessions which would enable the companies to resume business, and in June, 1914, an agreement to the following effect was reached: (1) Suit would be entered to test the constitutionality of the law and the Insurance Board would not enforce the provisions of the act until the question of constitutionality had been decided by the courts, (2) a committee should be appointed to make a study of rate laws with a view to formulating legislation on this subject, (3) all companies which had withdrawn from the state were to be permitted to resume business there without penalty, (4) rates would be reduced by the companies' Actuarial Bureau wherever improvements were made, and (5) a Business Men's Committee guaranteed the faithful execution of the agreement. The companies accordingly returned to Kentucky and the Circuit Court on June 12 held the act to be unconstitutional.

The following arguments have been advanced as showing the inadvisability of a state rating law. Some of them also apply to laws permitting the state to revise rates.

1. They interfere with freedom of contract in a business which is of a private and not a public nature.

2. It is unfair for the state to limit the amount which the companies may collect in premiums, without guaranteeing them against loss.

3. It is unfair to require the companies to contribute by taxation to a state rating board which may be of no benefit to them or

[25] See the insurance periodicals of this period, for instance, the *United States Review*, March 12, 26, April 23, 30, 1914. A very similar situation developed in South Carolina in 1915–1916, the outcome of which remains to be seen.

the public and may be more costly than their own private method of fixing rates.

4. Political influence may exert a power. In this connection the words of the insurance commissioner of a state where a rating law is in force are interesting. "The law should be framed so as to eliminate politics from the board. If they can keep politics out of the board, in my opinion the system will be a success." [26]

5. State management is usually inefficient. This argument (often merely a broad assertion) may be dismissed immediately, as being no more applicable to insurance than any other subject, even if true, which is open to question.

6. The inequalities and lack of relation present in state and local taxation afford a presumption that the fire tax will be improperly distributed under the state's supervision.

7. If the state assumed entire control of the business it could not accomplish its objects judging from the failure of state insurance in other countries to reduce rates or yield a profit. What can be accomplished then by merely fixing rates, except to make the companies bear the unjust burden of any losses which may result?

8. Average and distribution are bases of fire insurance and rates cannot be correctly or safely fixed without them. Rates should, therefore, not be founded on the experience of a single state. Nevertheless, the city of Austin, Texas, appealed to the State Insurance Board for a reduction of rates on the ground that the rates of Austin should be fixed upon the city's own experience and that citizens of Austin should not be taxed to pay for fire losses elsewhere.

A statement of a state fire insurance commission claims the following advantages for a state rating law:

1. The elimination of discriminations in favor of the large insurer and in favor of certain localities and classes of risks.

2. A reduction in insurance rates:

   (a) By improvements in cities causing reductions in their key rates.
   (b) By improvements in individual risks.
   (c) By the removal of unnecessary hazards and the reduction of hazards necessary to the risk.
   (d) By elimination of faults of management.

[26] John S. Patterson, Texas, *Nat. Conv. of Ins. Commissioners*, September, 1915, p. 163.

(e) By preventing insurance companies from advancing rates when temporary conditions and bad losses in certain localities make them desire to do so.

3. Stability of rates and schedules and accessibility of information regarding the process of ratemaking.

Several obvious comments may be made regarding these claims. The desirability of the elimination of discrimination cannot be disputed nor the ability of the state to accomplish this denied. Improvements in cities, in individual risks and in conditions surrounding risks, however, could and did take place before the state rating system was ever in effect. The rating schedules used by the companies provided allowances for such improvements. With reference to the success in preventing rate advances, it is hard to see any equity in preventing advances in rates if such advances are justified. Information regarding rate-making, however, is due the public, and it is unfortunate that fire insurance rating bureaus, local boards and associations did not sooner realize the necessity of a campaign of education.

The principal advantages of the state rating acts were that they fully admitted the necessity of having but one rate for each risk, thereby endeavoring to secure the same result as the advocates of coöperation, and second, the removal of certain evils which had existed, and with which coöperation had not sufficiently developed to cope. But it is also evident that the possibility exists in state rating laws for evils fully as serious as those which are removed, especially political corruption, ignoring the principle of average and inadequate rates. It is, therefore, legitimate to inquire whether equally great benefits might not be obtained from legislation of another character.

*Regulative Statutes.* At about the time state rating acts were being considered in Texas and Kentucky, a New York legislative committee transmitted a report recommending that the companies be allowed to continue coöperative rating under the regulation of the state, and in 1911 a law was passed with the following important provisions:[27]

1. Corporations, associations and bureaus for suggesting,

[27] New York, Laws 1909, as amended by Laws of 1911, Chap. 460, and Laws 1912, Chap. 175.

approving or making rates to be used by more than one underwriter are required to

(a) File with the insurance commissioner their articles of agreement, by-laws and a statement of the names and addresses of members.
(b) Submit to supervision and examination by the insurance commissioner at his discretion and at least triennially.
(c) File rates and schedules at the request of the commissioner.
(d) Keep records of proceedings and furnish the insured with information as to his rate and a copy of the schedule by which the same is computed.
(e) Provide means for hearing interested parties before the proper committees.

2. Associations and bureaus are prohibited from

(a) Discriminating in rates; the commissioner may hear cases and order discriminations removed.
(b) Requiring that all insurance be purchased from members of such organizations.
(c) Requiring that rates quoted depend upon the placing of the whole or a specified part of insurance at such rates.

A certain degree of progress in state action is apparent in legislation of this nature, which permits coöperation by insurers, with its attendant advantages, and on the other hand prohibits and adopts means to eliminate the abuses which have existed. In 1913 two other states, North Carolina[28] and West Virginia[29] passed laws identical with that of New York, although North Carolina has since added a provision for a hearing and examination of rates and a decision regarding their fairness, leaving correction to be accomplished by force of public opinion. But even more important has been the endorsement by the National Convention of Insurance Commissioners of the idea of regulated coöperation. One of its committees, after an investigation, came to the conclusions that,

1. Rates were at present made coöperatively.
2. This coöperation exists in spite of attempts to prohibit it.

[28] North Carolina, Laws 1913, Chap. 145.
[29] West Virginia, Acts 1913.

3. The requirements of safety and economy both make inapplicable to insurance the anti-monopoly, anti-trust and anti-compact laws looking toward unrestricted and open competition.

As a result of its investigation the committee submitted for adoption throughout the United States six model acts,[30] as follows:

1. An act similar to the New York law just described, providing for supervision and examination of rating bureaus.

2. An act prohibiting discrimination in rates and any requirement that the whole or any part of a risk be placed with certain companies.

3. An act requiring companies to maintain and coöperate with a public rating bureau, with equitable apportionment of expenses and equal voice in its actions.

4. An act requiring a written survey of each risk specifically rated by schedule.

Two other bills, favored by a number of the committee members, were not adopted by the committee as a whole, viz:

5. Prohibiting agreements between companies except such as are permitted by law, and

6. Authorizing the insurance commissioner to review rates and correct the same, subject to court review.

The latter two acts are in the nature of concessions to existing legislation, and as such a compromise with the principle of coöperation with regulation.

A report to the National Convention in April, 1915,[31] indicated that the first of these laws was in existence prior to 1915 in six states, and was enacted in three additional states by April, 1915. Laws prohibiting discrimination [32] were in force prior to 1915 in ten states and three additional acts of this nature were passed by April, 1915. Act No. 3 had been passed in two states by April, 1915. Massachusetts and North Carolina laws provide for a general review of all rates with only the power to make recommendations. Kansas, Kentucky and Minnesota have laws authorizing the insurance commissioner to review rates made by the companies and order the proper rate substituted. Missouri authorizes the insurance super-

[30] National Convention of Insurance Commissioners, December, 1914, Proceedings, pp. 19–24.

[31] N. C. of I. C., April, 1915, Proceedings, pp. 11–12.

[32] Not all following the model bill.

intendent to order rate reductions which will insure only a reasonable profit to the companies. Oklahoma delegates similar power to an insurance board. New Hampshire has long had a law enabling the insurance commissioner to review rates and fix a reasonable rate at which companies are required to write business under penalty of a fine. Although existing laws are difficult to classify because of the variety of their provisions,[33] the following table[34] shows approximately the legislative situation with respect to fire insurance rates and rating associations at the present time. Column A contains the names of states having an anti-compact law, forbidding companies or agents from combining to fix rates. Column B enumerates the states in which an act providing for the supervision and examination of rate-making bureaus and associations is in force. Column C shows the states in which there is an act prohibiting discrimination in fire insurance rates. Column D indicates the existence of acts requiring companies to be members of a rating bureau. Column E shows the various state acts permitting agreements between companies relative to rates, subject to the approval of the insurance commissioner. Column F shows the existence of acts providing for the making of rates by the state. Column G indicates the acts which authorize representatives of the state or state officials to revise or compel revision of rates made by the companies.

| *A*[12] | *B* | *C*[13] | *D* | *E* | *F* | *G* |
|---|---|---|---|---|---|---|
| Ala.[10] | ..... | ..... | ..... | ..... | ..... | ..... |
| Ariz. | ..... | Ariz. | ..... | ..... | ..... | ..... |
| Ark. | ..... | Ark.[11] | ..... | ..... | ..... | ..... |
| Ga. | ..... | Ga. | ..... | ..... | ..... | ..... |
| Idaho | Idaho | Idaho | Idaho | Idaho | Idaho | ..... |
| Iowa | Iowa | Iowa | Iowa | ..... | ..... | Iowa |
| Kan. | ..... | Kan. | ..... | ..... | ..... | Kan. |
| ..... | Ky. | Ky. | Ky. | Ky. | ..... | Ky. |
| La. | ..... | La. | ..... | ..... | ..... | ..... |
| ..... | ..... | Mass.[5] | ..... | ..... | ..... | ..... |
| Mich.[3] | Mich. | Mich. | Mich. | ..... | ..... | Mich.[4] |
| ..... | Minn. | Minn. | Minn. | Minn. | ..... | Minn. |
| Miss. | ..... | ..... | ..... | ..... | ..... | ..... |

[33] For instance in Iowa the old anti-compact law was allowed to remain on the statute books and in addition acts similar to the model bills Nos. 1, 2, 3, 4, and 6 were passed. In certain states some authorities still hold the anti-trust statutes to apply to insurance companies.

[34] Compiled from replies to inquiries sent to the state insurance departments.

| *A*[12] | *B* | *C*[12] | *D* | *E* | *F* | *G* |
|---|---|---|---|---|---|---|
| Mo. | Mo. | Mo. | ..... | ..... | ..... | Mo. |
| ..... | ..... | Mont. | ..... | ..... | ..... | ..... |
| Neb. | ..... | ..... | ..... | ..... | ..... | ..... |
| N. Hamp.[8] | ..... | ..... | ..... | ..... | ..... | N. Hamp.[9] |
| N. J.[7] | ..... | N. J. | ..... | ..... | ..... | N. J.[4] |
| ..... | N. Y. | N. Y. | ..... | ..... | ..... | N. Y. |
| ..... | N. Car. | N. Car. | ..... | ..... | ..... | ..... |
| Okla. | Okla. | Okla. | ..... | Okla. | ..... | ..... |
| Ore.[3] | ..... | ..... | ..... | ..... | ..... | ..... |
| ..... | Penna. | Penna. | Penna. | Penna. | ..... | ..... |
| S. Car. | S. Car. | S. Car. | ..... | ..... | ..... | S. Car. |
| S. Dak.[2] | ..... | ..... | ..... | ..... | ..... | ..... |
| Tenn. | ..... | ..... | ..... | ..... | ..... | ..... |
| Tex. | ..... | Tex. | ..... | ..... | Tex. | ..... |
| Wash.[3] | Wash. | Wash. | ..... | ..... | ..... | Wash.[6] |
| ..... | W. Va. | W. Va. | ..... | ..... | ..... | ..... |
| Wisc.[1] | ..... | ..... | ..... | ..... | ..... | ..... |

[1] In Wisconsin the law forbids companies from fixing rates and requires that they be fixed by local boards, composed of local agents.

[2] In South Dakota rates are made by a general inspection company and associations and companies must file affidavits that they are not in an agreement to maintain rates.

[3] Inspection bureaus may, however, be formed.

[4] Only where rates are discriminatory.

[5] A board constituted to hear cases and make recommendations—enforcement depends upon public opinion.

[6] Only where the rate is so low as to endanger solvency.

[7] The courts have held combinations illegal.

[8] Applies only to companies not incorporated in the state.

[9] Upon complaint.

[10] Companies are compelled to pay 125 per cent of any loss if members of a tariff association.

[11] Law requires all rates made under the same schedule to be uniform.

[12] This compilation does not include general anti-trust acts, not specifically enumerating insurance, which exist in many states, as previously described. In Illinois a fire insurance combination is now being prosecuted by the insurance superintendent under such a law.

[13] This compilation does not include so-called anti-rebate laws, prohibiting agents from returning to purchasers of insurance any portion of their commission for writing the business.

The following states and territories have no legislation of the types considered: Alaska, California, Canal Zone, Colorado, Connecticut, Delaware, District of Columbia, Florida, Hawaii, Illinois,

Indiana, Maine, Maryland, Nevada, New Mexico, North Dakota, Ohio, Philippines, Porto Rico, Rhode Island, Utah, Vermont, Virginia, Wyoming.

## RESULTS OF REGULATIVE LEGISLATION

The tendency during the past two years has been unmistakably toward a type of legislation which recognizes the difficulties of state rate-making and on the other hand shows appreciation of the right of the public to be protected from arbitrary action and unnecessary inequity. The advantages of a statute combining the principles of private coöperation and public regulation may be most concretely shown by a review of the results where such a law has actually been in existence.[35] One of the oldest laws of this nature is that of New York, passed in 1911 after a very thorough investigation of fire insurance conditions. This state thereby became the leader in this kind of fire insurance legislation as it was in certain phases of life insurance legislation some years ago. The results of its activity were as follows:

1. As shown by the map on page 177 four rate-making associations operate now and have for some time operated in New York state. One of the results of delegating the power of supervision to the superintendent of insurance was to bring about coöperation and harmony of action among these associations. While the first impulse in this direction came from the state, the associations readily responded and brought about many reforms on their own initiative. Frequent meetings of managers of the respective associations resulted in the adoption and promulgation of uniform rules, practices and forms. Thus the conditions were removed which occasioned the statement by an investigator in 1913 that "no one person is familiar with all these rules and until recently there has been no systematic attempt to collate them." [36]

2. Along with the former diversity of rules went non-uniformity in rates. A second beneficial result of the work of supervision has been to gradually eliminate inconsistency in premium charges. Variance between rates on risks of the same degree of hazard but

[35] A considerable portion of the data for the following statements was obtained from a letter to the author by Hon. J. L. Phillips, Superintendent of Insurance of New York.

[36] See *Fire Underwriters' Associations in the United States*, pp. 41, 42.

located in the jurisdiction of different rating associations, inequalities in rates charged by the same association on similar risks in different portions of its territory and unjust distinctions between different classes of risks were all considerably remedied. It is stated that it was not necessary to make frequent application of the power vested in the superintendent of insurance, its mere existence accomplishing the desired results in most cases.

3. As has been previously stated coöperation has been a status favorable to the development of a science of fire rating, one of the most important phases of which development was the supersedence of "judgment rating" by "schedule rating." The New York law has encouraged this. Dwelling and farm schedules have been devised with the resultant advantages of schedule rating, all of which cannot be enumerated here.[37] It is sufficient to say that thereby discrimination is more surely detected and avoided and property owners are made more fully aware of the deficiencies of their property. Thus the law seemingly offers no check to the preventive and protective functions of the associations.

4. To some degree the law has resulted in satisfying the well-nigh universal desire for lower rates. During the first few years the orders to remove unfair discriminations resulted in a considerable saving in premium, to an amount suggested by careful estimates as $1,000,000 per annum. In many cases the removal of discriminations resulted in readjustments which lowered some rates and advanced others, without extensively reducing the total premium income obtained on the class as a whole. Unascertainable saving in premiums resulted also from owners remedying property defects which were indicated.

## CONCLUSION

In many directions the legislators have sought a method of removing unsatisfactory conditions among the agencies engaged in fire insurance rating, sometimes recognizing the fundamental principles governing the business of furnishing indemnity, but often ignoring or being ignorant of such principles. The statutes passed and considered have been prompted by a variety of motives and have had a variety of effects, but there is faintly discernible in early years, and distinctly apparent in later years, a tendency to

[37] See F. C. Moore's *Universal Mercantile Schedule*, p. 8.

recognize, in a measure, the benefits of coöperation. The companies as well as legislators and officials have made mistakes, but many in both groups seem now to see a method of procedure which affords a solution of the difficulty. One of the principal agencies of late years in bringing about a more rational treatment of the problem involved has been the National Convention of Insurance Commissioners, which at first encouraged the study of public questions and recently has made some progress toward concerted state action, the necessity for which is shown by the variety of laws in the preceding table. Perhaps through this association some of the inconsistencies of legislation may be removed.

Eliminating from consideration state insurance, which is not yet seriously considered as a general method of procedure but rather as a last resource not yet required by the exigencies of the case and the problem of acquiring uniformity of state action, a partial answer to which is furnished by the National Association of Insurance Commissioners, two phases of the question of what agency shall make fire insurance rates are apparent.

1. Shall competition or coöperation be admitted as the basis for ratemaking? This question appears to have been answered in favor of coöperation. This paper has attempted to outline the history of the conflict between these two ideas, to indicate the reasons for the ineffectiveness of legislation intended to enforce competition and to show that a second and different problem has now appeared.

2. Is the public interest better served by allowing the insurers to fix rates under regulatory statutes or by delegating price-fixing powers to state officials under state rating acts? This question has not become a distinctly recognized issue because it is possible in the United States for two radically different methods of regulation to exist for some time in different sections of the country without any definite decision in favor of either. It is probable, however, that in the near future the last-mentioned problem will become one of the most important in fire insurance.